Renovating Housing Policy

The Grattan Cities Program's new report looks at home ownership in Australia, and government policies that promote the 'great Australian dream'. We assess whether policies that support home ownership and property investment achieve their objectives and represent value for money. We also consider the implications for how productively our cities function, how opportunity is distributed, and the impact on the 1 in 4 Australian households who rent their housing.

At this free public seminar, Peter Verwer, CEO of Property Council of Australia, discussed Grattan Institute's new Cities report with author, Jane-Frances Kelly, Director of the Cities Program.

Speakers: Jane-Frances Kelly, Cities Program Director, Grattan Institute
Peter Verwer, CEO of Property Council Australia

Moderator: James Button, Grattan Institute

JAMES BUTTON: Introducing Jane-Frances Kelly who is the Cities Program Director at the Grattan Institute. Jane-Frances has held that position since 2009 and in that time Grattan Institute has done a whole range of work - some of you will have followed it, on the state of our cities. And as Jane-Frances will explain in a minute, that work has led her to this report about home ownership in Australia and whether government policies are helping or hindering rates of home ownership and the capacity of Australians to enjoy secure and satisfying housing. And on my left, Peter Verwer is Chief Executive of Property Council Australia which is the leading advocate for Australia's $670billion property industry.

Jane-Frances, please tell us what this report is about, why Grattan has come to write this report at this time.

JANE FRANCES KELLY: Yes, so a couple of years ago we spent about 18 months doing research and reports about housing in Australia. We looked at demand for housing and the kinds of choices that Australians would like to be able to make, the kind of trade-offs, and looked at what was happening on the supply side where we found that there's a whole range of issues restricting supply in Australian cities. We followed that report up with a report of recommendations for increasing housing supply. So the first report was called *The Housing We Choose*, the follow-up recommendations was called *Getting The Housing We Want*, and, looking back on it, those were terrible titles to have chosen because they're quite similar and I think I'm possibly the only person in the room that gets them straight, and even I don't get them straight absolutely all the time.

Then earlier this year we published a report called *Productive Cities* and when we were doing that work we realised and knew that what is built where and who gets to live where not only dictates whether we're able to make the kind of housing choices we want to make, the kind of trade-offs we want to make, but it also really effects the productivity and fairness of Australian cities. And so thinking back to the work that we did a couple of years ago, we were aware that there was a gap in the analysis that we'd been doing - and we were explicit about it at the time, that was fine – which was that there are a series of government tax and welfare policies in particular that we hadn't looked at which would be affecting the housing market. And so having realised and knew, if you like, how important is as economic infrastructure as well as social infrastructure, we went back to take a look at what effect those policies have on housing.

And one of the things that this report is trying to do is take a look at what effects these government policies are having right throughout the housing system. It's an incredibly complex system and we certainly haven't tried to do a completely comprehensive look at everything that affects housing in Australia. For example, we don't look at social housing, not because it isn't very important, it is, but because it's 4% of stock in Australia and we were concerned about that there was less attention being given to effects on the other 95% of stock. So despite the fact that housing is so important to all of us, we all need a roof over our heads, and that it's so important to the economy, we found that there was a lack of parts of government, for example, that take the big picture of housing, that see all the different parts of the system and how complex it is, and that was one of the things that we wanted to try to bring to the conversation was these housing policies in a broader context and how they relate to who lives where and the productivity of our cities. And there's obviously lots more to say, but I'll let you.

JAMES BUTTON: You might say a little bit more though about what areas you explored. You mentioned the tax and welfare areas, that's one of the areas that you explored, but perhaps before Peter speaks you can just take us through the areas that you look at in the report?

JANE-FRANCES KELLY: Sure, so we took a look at the government policies that effect access to how ownership, so the kind of tax breaks that home owners receive, the kinds of tax incentives that there are for property investment. We took a look at the situation in the rental system and how that's related to those other to as well, and what we found in brief was those policies give very generous tax breaks to homeowners even though there are many private incentives to buying homes without them, so people would probably do them anyway. And it's quite a lot of government outlay but, even more problematically for us, some of them are really counterproductive and are making it harder to get into home ownership at all and so we looked at those ones in particular.

JAMES BUTTON: Yes. Peter, you've read the report and you've heard Jane-Frances summarise it very briefly. I'd like to get your response to the report and Jane-Frances' comments and whether you believe that the tax and welfare system as it exists and the concessions that exist are doing what they're supposed to do in terms of generating supply, ensuring that the housing market is working?

PETER VERWER: Thank you. And it's a really great privilege to be speaking to the Grattan Institute. The Property Council hearts the Grattan Institute and we like it a lot, not because we agree with what they say necessarily but because it's provocative, edgy and at the very least it forces us to reconsider our own positions, and that's pretty much where the good news ends with this report.

The virtues of this report are that it outlines a really serious problem which is housing policy in Australia, because there is no housing policy in Australia that could be called coherent. And the thesis of the report is really quite elegant in the sense that Jane-Frances and the team have said that housing, both housing in the rented sphere but also the owner-occupier sphere, creates a range of public and private goods and that if we act together as a nation we would try and maximise in an equitable and efficient and non-distorting manner these public and private goods. And we'd have policies which did this in a way where the benefits outweigh the costs and that particular parts of society weren't getting a free ride. Is that fair?

JANE-FRANCES KELLY: Very elegantly put.

PETER VERWER: So far, so good. So that's the good bit I think, it's just the analysis and the recommendations that we disagree with and it's for these very brief reasons, and I'll state them and then you can get stuck into me later on.

I think the first misgiving we have is that, as Jane-Frances said, they weren't dealing with social housing and they're not dealing with anything but a particular portion of the housing complex, and yet they say this is a very complex issue but then narrow themselves. I understand that and that's your report, but unfortunately it's meant that you've had to focus on a particular part of public policy which is effectively the tax arrangements, and that's where I think the report comes a cropper. So narrowness I think is an issue here because that also impacts on the recommendations. The other really big problem is that even if the analysis was correct and even if the recommendations were implemented, it's not going to move the dial. That is to say, it's not going to create more public and private goods from a better housing regime in Australia. The third problem is that I do think it cherry-picks some of the literature, but we won't go into that - it's your report, at least it's creative.

But the knockdown argument is this, that by arguing that there are a huge range of tax benefits that accrue to particular parts of society that add up to $36billion – so this is the main media line of the report, which all of the media has picked up – that there is a $36billion free ride that home owners get and private investors get and what the report is really saying is that that free ride, that $36billion free ride, is distorting Australia's housing policy settings. The problems with that are firstly, the language of the report starts with "tax expenditure" so this is like theoretical tax that you could get if you had policies like a couple of other nations on the planet. So it's just theoretical, but then it becomes subsidies, and by the end of the report they're actually talking about outlays. In fact, the first sentence of the conclusion is that "Government outlays on housing policy are huge and their effects are huge". Well, they're not outlays. They don't exist, but because the word "subsidy" is used there and has been fed to the media, you have this gargantuan phantom of free riding dollars that go to particular parts of society which doesn't exist.

The second problem we have is what about the other side of the ledger? A fair report would say okay, you're getting this free ride but we're also going to balance that up with the other inefficient badly-designed taxes that you do pay and at least net that off. And the report doesn't even go close to that. But my main problem is not even those things, it's that the $36billion figure is a load of cobblers, that this pinnacle of perks, of land tax that home owners don't have to pay, of net imputed rent, that the CGT concession, that the pension test perk and, of course, the hoary old favourite, negative gearing; that they all add up to this massive benefit. And the thing is, if the report had actually analysed the true impact of these particular measures then in fact it would come up, I think, with a totally opposite conclusion. I'm very happy to go into the components of the pinnacle of free riding if you like.

JAMES BUTTON: Is that what the report said, Jane-Frances, that home owners get a $36billion free ride?

JANE-FRANCES KELLY: No.

JAMES BUTTON: That wasn't my understanding of the report, but.

JANE-FRANCES KELLY: No, and actually, I think this is possibly the first time in public that I've defended the way that the media has interpreted it, but we were quite pleased that the media didn't lead with that number because the report is not about that big number, it's about the effects that government tax policies are having on how hard it is to get into home ownership. And I think that's

something that you would agree with, that it's harder now to get into home ownership in Australia than it used to be?

PETER VERWER: We agree the public policy settings here are totally suboptimal, but it is not true. Every one of the media reports talks about the $36billion and they all lead with it, and I've got a pile of clippings here that indicates that. And you must have known they were going to do that, and it's a sleight of hand.

JAMES BUTTON: But the broader point that Jane-Frances is making is that, as you were saying yourself Peter, the system is suboptimal and that the tax and welfare concessions that we have are not producing the result that we want. So do you agree with that, that the tax and welfare concessions are not producing that result? And if you agree with that, are the taxes that we point to the villains here or there should be other taxes that need to be changed in your view? Or is it some other problem that needs to be addressed?

PETER VERWER: Well, hang on a tick. You can't write a whole report which actually analyses the tax and welfare system and then draw conclusions based on that analysis and say "That's not what we're really talking about".

JAMES BUTTON: No, that's not what I'm saying. I'm saying that –

PETER VERWER: But it's exactly what you're saying.

JAMES BUTTON: No, it's not.

PETER VERWER: You're saying that you've got an entire section of this report which adds up all of the benefits and you say it's because of this that we have a distorted system. Now, we have a distorted system, but it is not because necessarily of these particular tax benefits.

JANE-FRANCES KELLY: No, we don't say that it's because of that $36billion, but having added up the generosity of the tax breaks given to home owners and to property investors and investigated some of the effects that that has on getting into the system, it's certainly the case that we can focus on that number and have you say that because we didn't look at the other side of the ledger that it's not a fair representation of what's going on. But what we were interested in was asking what is it that's going on in the housing market that is making it so hard to get into, rather than saying these are the tax breaks that are given in order to facilitate or encourage a property sector that gives this much in tax. I don't know whether the property sector pays too much or too little in tax or whether it's a good deal or not, that wasn't our question.

JAMES BUTTON: Are tax breaks unfairly skewed toward investors and home owners?

PETER VERWER: No.

JAMES BUTTON: No.

PETER VERWER: The thing is, people do chime with that number and that's totally legitimate, but that's why I think it's actually important to be able to defend the numbers that are in there from a Grattan Institute perspective.

JANE-FRANCES KELLY: And we do and can.

PETER VERWER: You do and can?

JANE-FRANCES KELLY: Yes.

PETER VERWER: Well, there you go, well let's do it then. Because, I mean, there are people in this room who disagreed with my statement which is why I'm here representing the dark side of the force. And so everything does come down, I think, to whether or not each one of the elements of that tax pyramid are accurate, whether each one of them do distort or do not distort decision making in the marketplace.

JANE-FRANCES KELLY: We made our recommendations about the ones that we did think were distorting and it's probably better to focus on that because there's no real point in talking about how daft it would have been to make recommendations that we didn't make, because we agree it would have been daft to make those recommendations and that's why we didn't make them. So, rather than going through each of those numbers, all of which are in the government budget papers and so on, we agree that net imputed rent is a somewhat theoretical concept. It is counted in the government accounts. It is regarded as something representing economic value that home owners get and people who do not own homes don't get. So we were reflecting what is counted by governments.

PETER VERWER: Sure but, as you say, I wasn't planning to pick on that because you said we weren't going to talk about it and then just went and talked about it. I'm happy not to touch that, just let's deal with the things in the recommendations.

JAMES BUTTON: I think it will be of greater value to the audience if we discuss whether the system is working to achieve the effects that we think it is. You think it is Peter, that the taxes we described in the report are not having the distortionary effects that the report says that they are?

PETER VERWER: I think the entire tax system is suboptimal. The entire tax system is badly designed, but it's come from -

JAMES BUTTON: What about in relation to property though?

PETER VERWER: Particularly in relation to the property industry. The tax system in relation to the property sector focuses on inefficient sectors, on very narrow bases. It charges the wrong people, it charges superannuants too much, for instance. So you have no argument with me on that. Nevertheless, you propose something specific in your report and I disagree with that. Jane-Frances, if she can -

JANE-FRANCES KELLY: The specific thing that you disagree with is, that we propose is?

PETER VERWER: The negative gearing issue; the CGT concession. Happy not to talk about net imputed rent -

JANE-FRANCES KELLY: Well, particularly since we don't make a proposal about it.

PETER VERWER: Exactly. We're on a unity ticket on that one, especially in terms of the pension test given that we're on a unity ticket on that issue. And land tax where we actually agree with the recommendations, because that really is symptomatic of the discussion we're having and that is a tax modernisation program in Australia would trade-off inefficient taxes, such as stamp duty, and replace them with broad-based low rate taxes where there are minimal exemptions, such as land tax.

JANE-FRANCES KELLY: Well, this is part of our point about the complexity of the housing system in that there's nobody really who is understanding what all the effects of all of these policies are adding up to. Stamp duty is not even a housing policy, it's a revenue raising mechanism on the part of states, but it has effects on the housing system particularly in the situation where we have very restricted supply. I cannot resist going back to your first part where you talk about that we take such a narrow look at the housing system. We were completely clear in this report about the bit that we were biting off because we had spent so much time on the supply side beforehand. And you're right that we only look at a portion of the housing stock, it's just that that portion is 95%. So it's not a small portion.

So stamp duty is not even a housing policy and yet in that context of very restricted supply it means that we're unable to use our current housing stock as well as we possibly could because people have really strong disincentives to move house to one that might suit them better or be closer to job opportunities. So I know that that's one that we agree on.

PETER VERWER: Yeah, we took this to the Tax Summit. I mean, it was the Property Council -

JANE-FRANCES KELLY: I know, I think we quote you in fact.

PETER VERWER: At the Tax Summit that said we would offer up a discussion on land tax of the system rotating to a focus on land tax in order to get rid of an inefficient tax like stamp duty, which is highly distorting for all of the reasons that you have mentioned.

JAMES BUTTON: Can I just butt in with a bit of history here, and I'm going to ask you a question from it Jane-Frances, which is in 1961 home ownership rates in Australia reached 72% and they've been more or less steady since then. But in recent years they have slightly, but have started to go down, however they have gone down sharply amongst two groups, that's people on low incomes and the young, people 45 and under.

JANE-FRANCES KELLY: I love it when I get to describe the young as people 45 and under!

JAMES BUTTON: That's right, and the older you get, the more they are the young. But there is something going on, even though our overall home ownership rates are not far off the 72%, something is going.

JANE-FRANCES KELLY: Yeah.

JAMES BUTTON: And this report is an attempt to grapple with that issue as I see it.

JANE-FRANCES KELLY: Yeah, that's right.

JAMES BUTTON: And I wonder if you could talk through what you see as happening there and the impact of what we talk about in the report on those home ownership rates?

JANE-FRANCES KELLY: Yeah. So we've talked about the stamp duty thing and we agree on that. I will answer your question. I would love them, before we start talking about negative gearing, to talk about the rental system because I think that that is really important as well and just so frequently gets left until last in the conversation.

JAMES BUTTON: And you might give the numbers on the renting in Australia?

JANE-FRANCES KELLY: Yeah, 25% of Australians rent.

JAMES BUTTON: And half of them for five years or more, it's a long time isn't it?

JANE-FRANCES KELLY: Yes, exactly. On what has happened within home ownership rates, so you're right, they've been kind of steadily up and down or roundabout 70% for decades now. They're 68.5% right now but yes, as you say, among younger cohorts under 45 there's been a much, much steeper decline.

So we asked the question of whether houses have become harder to buy, because the phrase that gets used a lot is "housing affordability" but it's never been clear to me what that means. Once you start unpacking the assumptions that the term "housing affordability" has you quickly get down to having to make judgments around what is reasonable to expect: that every Australian should be able to buy a house by the age of, what, 28, 19, 18; and on a single income, rather than a double income? So that didn't really make much sense to us, and also a lot of the housing affordability indicators that are used didn't seem to make much sense to us because incomes overall have increased a lot over the last few decades and what that means is that people can choose, as their income increases, to spend more on housing. So I remember I was sitting at a roundtable where someone was saying the indicator of housing stress is if over 30% of your income is going on housing costs. And there were about 10 people at the table and they all looked at each other and said "More than 30% of my income is going on housing costs, but I'm not in housing stress".

So we found that phrase really very not useful and so we started asking why have prices increased so much over the last few decades? There's a range of reasons, one there's been an environment of lower real interest rates that means that it's cheaper to borrow more without affecting your mortgage payments, but the one that we really interested in in particular and have been looking at on and off for years, and we'll continue to, is this relationship between supply and demand. Demand has increased; the population growth; also decreasing size of households, so for the same population you need more dwellings; various other things on the demand side; and all of that has been in a context of very restricted supply and that has resulted in this structural increase in prices. What that means is that in the 1980s you needed a deposit of one year's average income to buy a house and now it's four years income. So it becomes very difficult to save for the initial deposit and so this is why we say that the current situation is causing a real divide between those who can get into home ownership and access the generous tax concessions that we identified and those who just get shut out of that.

JAMES BUTTON: And there are two points here, that there are generous concessions for people who already own homes and then there are concessions for investors, and the concessions for investors drive up demand without increasing the supply. Is that correct?

JANE-FRANCES KELLY: Yes, that's right.

JAMES BUTTON: Peter, your response to the historical picture that I painted, that home ownership has decreased somewhat, not massively, but it has decreased much more steeply among those two groups, of people on low incomes and people under the age of 45. What do you think is going on there and are policies such as negative gearing increasing demand and thereby driving up the prices of property and keeping people out of the market? There's two questions there.

PETER VERWER: Sure. Well, Jane-Frances has outlined why it is that it's becoming harder to rent, in fact why it's harder to buy -

JANE-FRANCES KELLY: Harder to buy.

PETER VERWER: Harder to rent and harder to buy?

JANE-FRANCES KELLY: Oh right, sorry.

PETER VERWER: So if you look at the National Housing Supply Council's most recent report, if you're looking at people in the bottom 40% they reckon that there's a shortage of rental housing that is close to 300,000 dwellings. So there's clearly a mismatch there. Now, the lack of supply accounts for a huge amount of this, so the relationship between supply and Australia's economic growth and its population growth have been moving out of synch for a very long time, over a decade. So a very major part of the problem is supply and that's also a part of the solution, which has been canvassed before but needs to be reaffirmed.

The other bit is demand. So Jane-Frances has mentioned interest rates. Money is cheaper than it used to be and therefore people, anybody, can bid up what they would pay for a house, and then there's the issue of negative gearing. So is negative gearing artificially bidding up house prices without creating supply? So that's the fundamental question. So the trap here is that we're not arguing that negative gearing creates fresh supply. It doesn't. Very little of the money that is expended that is geared, that is to say that is offset against all forms of income - which you can do in most OECD countries by the way - is used to create new housing stock, that is stock that didn't exist yesterday. However, it is creating housing for the rented market.

JANE-FRANCES KELLY: At the expense of housing that's available and affordable for home owners.

PETER VERWER: Correct it is, it is, yes. Well, the other way of looking at it is, it is liberating the housing from owner-occupiers.

JANE-FRANCES KELLY: So if what you were interested in if your objective were to maximise the amount of your restricted stock that was rental then yeah, you could argue that negative gearing helps to do that.

PETER VERWER: And that's not what I'm arguing, I'm arguing is that we should increase supply and we should focus on the supply issue, but we should not -

JANE-FRANCES KELLY: And we also argue that too.

PETER VERWER: Absolutely, my God, the unity ticket is getting longer. However, negative gearing is this straw man, straw woman, you know, it's a whole straw family here and the argument it is evil and if you got rid of it then you would have a less distorted marketplace which means we would create more public and private housing goods. And that thesis is incorrect.

JAMES BUTTON: Peter, isn't negative gearing in interaction with the capital gains discount, isn't that the thing that has driven up demand for investment property? It's not just negative gearing, which we've had for a very long time, but it's once you introduce that in interaction with the capital gains discount that it makes investment property extremely attractive in Australia?

PETER VERWER: Well, let's look at the capital gains tax discount. So, the recommendation in here well, Jane-Frances, does our unity -

JANE-FRANCES KELLY: No, first of all, well -

PETER VERWER: You want to reorder my arguments?

JANE-FRANCES KELLY: No. No, go ahead.

PETER VERWER: So the issue here then is, would you agree Jane-Frances that if we were going to reform CGT what you would do is you would still tax the real capital gain?

JANE-FRANCES KELLY: So, I really don't want to get hung up on the details of the recommendations of particular ways of putting together the two elements of those two tax incentives, not least because we are very careful not to make a specific recommendation about negative gearing in the report. We say that reform to that area should be considered because in a context of constrained supply, which is what we have and have had for some time, what it does is artificially inflate demand in a debt finance manner for a restricted range of properties. And so it is, it becomes a zero sum game between possible owner occupiers and rentals and bids up prices without stimulating any new supply. We agree that it definitely doesn't do that.

The main reason we don't make a very specific recommendation about how elements of it could be put together is that negative gearing applies to a range of asset classes and so essentially the Treasury would need to do a lot of complex modelling about the whole of the economy before they would figure out how it would be transitioned in and so on. It's not for us to create that complex implementation planning, but it's clear that in the current context we think it is bidding up prices, it's not stimulating any new supply, and so the recommendation is that reform to those tax incentives should be considered.

PETER VERWER: Well, this is my problem because the refusal to do this calculus means that you don't end up identifying the real problem. To answer your question on capital gains tax and because your recommendations, Jane-Frances, actually do say as one of the options that if you're gonna get taxed on capital gains you would do so on the basis of the real gain. The real gain.

JANE-FRANCES KELLY: No, what we mention are two well thought through proposals that other people have made.

PETER VERWER: Okay, but you mention them. Let me make my point which is this: that if you change the system so that you are only taxing the real capital gain I can tell you that on an ordinary old house with its usual 4.5% yield with 2.25% inflation, which is low, then if you only tax the real capital gain the government would be making less money than the current situation where you tax 50%. So in other words, there is nothing in it. It won't move the dial. And as for negative gearing, the issue with negative gearing I think is simple. The report shows, and as James has mentioned, there was a big burst when the government used to produce a lot of the stock in home ownership rates. And that levelled out for a long time and since then it's dipped in aggregate, it's dipped a little, it's dipped more for other parts of society.

So the government got out of the business of producing housing that could be rented. Large institutions don't want to go into that area. Why don't they? Because the returns are so miserable, you know, it's a 4% yield and the cost of maintaining houses is monumental which is why when you look at the money that government spend, the billions that government spend on housing for rent, they don't create any new stock; everything goes in maintaining that stock. So it's left then to small

investors, and the median investor who uses negative gearing only earns $80,000 a year. Less than 10% of the negative gearing credits go to people who earn more than $180,000 a year.

So in return, what do they do? They create 1.8million homes available for rent. They're not new homes, but they are 1.8million homes that would not exist unless a private investor is satisfied with the high compliance costs, the quite moderate rent and the maintenance costs to create all of this rented space. And you know what they get in return for this? Not the monumental benefit that keeps being talked about. In fact, on the Grattan Institute's own numbers – and thank you very much for these – the average investor, for delivering these 1.8million homes for rent, gets $25 a week from the government; that is about the same that they would get under the child allowance for a kid under 18. In other words, it is the deal of the century. If you didn't have negative gearing you'd have to invent it.

JANE-FRANCES KELLY: Well no, actually, before we go to the questions from the audience I do want to talk about the effect of a capital gains culture in the rental system on renters. I just wanted to get in about the rental system because, as I was saying, they always just get forgotten.

So yes, it's a quarter of Australians, the median age of the head of a rental household is now 37. So our sense that renting was what you did while you were saving a deposit to buy a house or when you were in transition is really extremely out-dated, that's really not the case at all. And in addition, because we're renting further into our lifetimes and for a whole range of reasons there are more children living in rental households. You get all sorts of renters, I am a renter myself. I remember watching some focus groups that we did a couple of years ago behind the screen or whatever and people were talking about what their view of renters was, that they're itinerant and they don't care, and you don't know who they are and so on. I was just sitting there going "I'm a renter. I've got three university degrees". Anyway, there's the entire range of people living in rental housing and I think that our stereotypes about it, our assumptions about it are enormously out-dated.

So, given that there are more children living in rental accommodation in particular, that made us particularly concerned about realising that in Australia there are some of the shortest lease terms available anywhere, it tends to be either a six month or a 12 month contract that then rolls to a month-by-month arrangement; that there's very short notice periods which is particularly important for kids because kids benefit from stability, you don't want to be bringing up kids in a situation where you might have to pull them out of school at a month's notice; and also in Australia there's a much more restricted sense that renters can make a home out of the place that they're living, and we're talking about small things like being able to put up pictures or keep small pets. And one of the reasons that this has come about we think is because a capital gains culture where you have a lot of investors who own maybe one property or two, the tenant is almost an accident of the type of investment instrument that those people have chosen. So those tax incentives have encouraged them to become landlords, but they're landlords almost kind of by accident. And it was very interesting to note that there's a lot of countries overseas where tenants can access better stability and more of a sense of making a home. We found a survey of renters in Australia that was fascinating. One of the top answers was that they wanted to be treated with a bit more respect by landlords and by rental agents and so on; they're not just an income stream for real people living elsewhere using them as a financial investment.

JAMES BUTTON: So the whole question of renting is one of the dimensions in the report that we haven't had a chance to discuss too much. The other one is about economic productivity and the impact on the productivity of our cities.

JANE-FRANCES KELLY: But we should throw it open now, I just wanted to get that in about renters.

JAMES BUTTON: So, open to questions from the floor. Does anybody have anything to ask Jane-Frances or Peter?

AUDIENCE: Jane-Frances, I noticed you mentioned just then the capital gains culture that landlords are in. I suppose one way to address that would be landlords would be, I suspect, more likely to hold onto an asset if the rental yield was greater and one of the measures of house prices being, some people would say, overpriced in Australia is our rental yields are lower here than overseas. So is there a risk that your policy mix might increase rental yields which might mean rental investors hold onto their assets, they give tenants better stability, it's more like a commercial lease than a rental lease?

JANE-FRANCES KELLY: That sounds marvellous, doesn't it?

AUDIENCE: However, what about if the rents are higher? Could there be a rental affordability crisis if rental yields are higher? Could that be a problem?

JANE-FRANCES KELLY: Well, the numerator and the denominator there can both shift. So if supply were to increase, which we're all on the unity ticket that that would be a great thing because it's enormously problematic for a lot of things if it doesn't, it could bring prices down somewhat and then your rental yield can increase without raising rents. It's interesting though, we quote John Howard in the report about the crude political calculus of all of this, if you like, because it's a politician's worst nightmare for house prices to go up and to go down. And I think we were talking to Saul Eslake about it and he was saying there's about 120,000 people each year who are buying their first home and for them lower prices are important, but there's about 8million of us who are owning our homes and – as John Howard put it – "No-one has ever complained to me about the value of their home going up".

AUDIENCE: To Peter. Thanks, I appreciate your candour. Can you talk a little bit about the Property Council's policy in regards to your Henry Submission Tax Review and the type of lobbying you're trying to apply to the federal government or perhaps the states? Just explain about the land tax option instead of the stamp duty and so forth, what does the Property Council want in the transition?

PETER VERWER: Thank you. Well, they're quite close to the ones that Jane-Frances has put in the recommendation which is that you trade-off inefficient stamp duties for a broad-based land tax and, in the ideal situation, you get rid of stamp duty and land tax and replace it with a very broad-based low rate property charge.

Now, the problem is the transition and a couple of options have been put in the Grattan Institute paper. The one that we prefer is to treat it a bit like the HECS, so one of the reasons we have a problem with the pillar of perks is that it's not as if the home owner doesn't pay land tax; they paid it upfront. They paid it in the stamp duty. So that's history, let's use that as a model though, give people a choice and say "If you've got an existing home, we're not going to apply land tax to it until there's a transaction and when a transaction occurs we'll give you this choice: pay the stamp duty upfront like you do now – like you do if you want to pay off your HECS loan in advance – or we will increase your municipal rates over the life of that asset". And then they'll say "Well, how much would my municipal rates increase by?" and the answer is, in order to raise the same money that was raised from the stamp duty system your municipal rates, if you pay $1,000 a year it would be about $2,300 a year. Now, the problem is, if you're going to take that gentle approach that takes more than a decade in fact to actually filter into the system.

AUDIENCE: Peter mentioned that there is agreement between you on the distortions created to capital gains by the pensions system. Would you just clarify what that agreement is?

JANE-FRANCES KELLY: I don't know, what do we agree on Peter?

PETER VERWER: I think we agreed not to talk about it.

JANE-FRANCES KELLY: No, I think we agreed not to make a recommendation to remove the exemption of the family home from pension asset tests.

AUDIENCE: Is there a reason why this is not to be discussed? To me, it was one of the major distortions -

JAMES BUTTON: No.

JANE-FRANCES KELLY: No, it's not that it's not to be discussed, I mean, go for your life.

AUDIENCE: No, to me it is one of the most inconsistent and unrealistic parts of the taxation system, that the family home is excluded from one's application for the pension. And I think you all know that larger numbers of people, with the encouragement of their children, invest substantially in a home and have no other assets worth reducing the pension and live on the pension to ensure that this family home can still be carried on into the next generation. It's a major distortion. Do you have views on it? I thought there was some agreement and I just want to know what that agreement is.

JAMES BUTTON: Yeah, and you'd also say there are other downstream effects as well aren't there in terms of -

JANE-FRANCES KELLY: Well, it disadvantages renters enormously, they really lose out.

AUDIENCE: My question is not it disadvantages renters. What is your agreement on that policy?

JANE-FRANCES KELLY: I don't know. He was the one who said we agreed on it.

PETER VERWER: I said we just agreed not to talk about it. We're going to have a totally different view on this.

JANE-FRANCES KELLY: I didn't agree not to talk about it.

PETER VERWER: Our view is something that you'll be appalled by, and that is that the goal here is to speed up the transition of big family homes that are no longer needed by families between generations. And to do that we need to remove the distortion which currently exists, and that is these people are often asset rich and they're income poor or they've got moderate income streams, they certainly become income poor when they're not earning a full-time wage any more. And so what we would do is we would exempt the home completely from the test and that way there would be less of a barrier for people to sell their homes and they would then put it onto the market so that families can use it and then they can move into age-appropriate accommodation.

JANE-FRANCES KELLY: And of course, one of the things that will facilitate that is that there's appropriate places within neighbourhoods for people to downsize to, which in many cases don't exist at the moment. So it comes back to the supply issue.

AUDIENCE: There is no institutional investment made in residential property in Australia. In the studies that you've undertaken Jane-Frances, but I'd also be interested in Peter's views, why is that? Do you have views on that?

JANE-FRANCES KELLY: Well, we would like to do more work on this in the future because there are many countries where there's much more institutional investment and it seems like that would be a good thing to happen in Australia to stimulate more affordable supply. We'd love to have covered that in this report. We put it out of scope simply because you can't cover everything every time.

PETER VERWER: I think the two reasons are the yield is too low -

JANE-FRANCES KELLY: Currently, yeah.

PETER VERWER: The total return is too low, it doesn't have enough bond-like characteristics, and the other main reason is that there's not the scale. So for an institutional investor, they really need to make very large placements. And the tax system is also biased towards it, so if an institutional investor actually wanted to create lots of new stock the tax system is designed to make it very difficult for them to put such a development in a real estate investment trust. And these things could be fixed along with supply.

JANE-FRANCES KELLY: Yes, sorry, when I said we want to do some work on it, it's on what could fix it.

AUDIENCE: General observation, but a question directed at Peter. It seems to me from the general conversation that there are not many winners out of this housing situation. If that's the case, apart from perhaps the governments and stamp duty, what is the compelling justification for continuing negative gearing? That's the key question. And if there is a compelling justification, what is the material value to the national economy? Because it's not the same as investing in manufacturing or investing in IT or investing in something that has ongoing continuing returns. And finally, you also make mention of quite a number of OECD countries have a very similar policy in place. Do those countries have the same benefits in negative gearing as our country offers or do they differ?

PETER VERWER: The reason negative gearing is virtuous is for the reasons I outlined before, but in summary it's because it actually does make 1.8million homes available for rent and our argument would be if you remove that negative gearing or you quarantined it, as was tried once before, it would make the situation worse. Your question on what's the real dividend to society from negative gearing? Well, that it actually provides much-needed shelter for a very large portion of Australians, over 20% of Australians, and where would it come from if it didn't arise from these small private investors? In fact, once again, it would actually make the situation worse.

JAMES BUTTON: Peter, wouldn't a lot of those 1.8million homes then be made affordable for people to buy?

PETER VERWER: Why would they exist?

JAMES BUTTON: Isn't negative gearing driving up the price of those homes and putting them out of the reach of would-be home buyers?

PETER VERWER: I do think that negative gearing does drive up, in some phases of the market, the price of homes. Yes.

JAMES BUTTON: Therefore it puts people out of -

PETER VERWER: No, but the answer to that is not get rid of negative gearing, because you're actually removing the incentive for investors to provide homes for rent in the first place. The answer is increase not only supply in aggregate, but types of supply and increase the choice of all renters and home buyers. The answer is supply.

JAMES BUTTON: But price is too high, yeah? The price of property is too high?

PETER VERWER: Because demand exceeds supply. Increase the supply.

JAMES BUTTON: And do nothing on the demand side?

PETER VERWER: That's not what we're saying here. You just hate negative gearing.

JAMES BUTTON: No, I don't. I don't have a view.

PETER VERWER: I've already outlined that what negative gearing does is it provides an investor who is going to create space that can be rented. What is not argued in this report is where that would come from if they didn't exist. One thesis which is put forward here is the benefits are high enough that they would just do so anyway. Well, if you're talking about a four-and-a-bit percent yield which occurs because of this tax arrangement, you take that tax arrangement away, which is provided in all of these other countries, and you will decrease the return even further. Reduce the incentive and they will withdraw from the market.

JANE-FRANCES KELLY: Just a couple of things. There are many countries with good rental supply that don't have negative gearing, so correlation is not causation. In addition, when it was quarantined in September 1985, in the two years that it was quarantined lending for private property investment went up 42%. So it's just wrong to say that when it was taken away everything went to pot, it absolutely didn't.

PETER VERWER: And I didn't say that. I didn't say that by the way, but if you want to start quoting numbers at me then do so. I've read the same Reserve Bank report and I've read Saul Eslake's stuff, Saul has a brilliant account argument of this, he has the best arguments. However when you look at the Reserve Bank numbers they show that rental inflation from the CPI series during that period when negative gearing was quarantined rose by 22%. And here's the killer number, everything I'm talking about today really relates to supply. If we had more supply in the right places with more choice so that people actually were able to make the most of what they wanted, then we would actually solve the problem. If you look at what happened to supply during the period when negative gearing was quarantined then it fell to the lowest number per capita as a proportion of GDP since numbers were kept; the lowest amount of money spent on houses since 1961 per capita as a percentage of GDP.

JANE-FRANCES KELLY: We're going to have to finish up, but I can finish on what we agree with which is that supply is far too restricted and needs to be fixed. Refer to 18 months of work we did on that.

AUDIENCE: In terms of supply, we've expanded the size of the Melbourne urban growth boundary by about the size of Canberra over the last decade, but still we see continually this ethical dilemma of the staged releases of land supply every month by developers out in the area. Atherstone Development is basically 99% undeveloped and it's been over two years, it's supposed to be on the market. So how are we going to encourage all this land we've already got available for housing onto the market when developers hold it for easy profits?

PETER VERWER: Developers aren't in the business of land banking so that they can make a super profit in the future. All of the developers who are listed want to get that land onto the market as quickly as possible in the green field site, and the thing is they actually want to get land which is in the inner areas onto the market as well. When it comes to urban densification, you had the developers at hello. They want to produce as much supply as possible, but the whole system is rigged against that. It is very, very difficult to do urban development, in-field development at scale which is what Jane-Frances has noted in previous reports. But we're very keen to do that, in fact this joined the Greens, launched by Christine Milne, in a Property Council report, the Greens and the Property Council. Why would the Greens actually have a unity ticket with the Property Council on the development issue? And the answer is because they also see supply and choice as going together. It's very, very difficult to change the demand fundamentals because most of them are driven by economic factors and demographic drivers.

So what we need to do is to get more supply in the existing suburbs around transport corridors, not touching the heritage suburbs, just make them no-go zones, but have more go-go zones. But it also means better utilising inside the urban growth boundaries. Plan Melbourne says right, that's it, we're not going to change it again, and you know why they say it? Because it's going to be pretty hard to actually move it further on. But the key there, as Grattan Institute has said in the past, is to make sure that when those so-called green field sites within the urban growth boundaries are developed, which we want to develop, which we can't develop at the moment because developer charges are so high – in Melbourne they're about $120,000 per lot, that is to say they are twice as much as the price of land – change that system, then we'll deliver the supply and that will solve the problem.

JAMES BUTTON: Jane-Frances, a quick response?

JANE-FRANCES KELLY: Our recommendations weren't specifically about developer charges. I really can't top the sound of Peter Verwer talking about go-go zones, so I think I'll leave it there other than to encourage people to read the report because you might find a slightly different report than has been described.

JAMES BUTTON: Thank you all for coming, I'm sorry we didn't have more time for questions but it's been a lively discussion and great that you all came. Thank you very much.

End of recording